

HOUGHTON LAKE COMMUNITY SCHOOLS
REPORT ON FINANCIAL STATEMENTS
(with required supplementary and additional information)
YEAR ENDED JUNE 30, 2007

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INDEPENDENT AUDITORS' REPORT

To the Board of Education
Houghton Lake Community Schools
Houghton Lake, Michigan

October 8, 2007

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Houghton Lake Community Schools, as of and for the year ended June 30, 2007, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Houghton Lake Community Schools' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Houghton Lake Community Schools, as of June 30, 2007, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

To the Board of Education
Houghton Lake Community Schools

October 8, 2007

In accordance with *Government Auditing Standards*, we have also issued our report dated October 8, 2007, on our consideration of Houghton Lake Community Schools' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages vi - xi and 24, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Houghton Lake Community Schools' basic financial statements. The additional information on pages 26 to 36 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This additional information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink that reads "Mamer, Costenison & Ellis, P.C." The signature is written in a cursive, flowing style.

Certified Public Accountants

MANAGEMENT’S DISCUSSION AND ANALYSIS

This section of Houghton Lake Community Schools (HLCS) annual financial report presents our discussion and analysis of the District’s financial performance during the fiscal year that ended on June 30, 2007. Please read it in conjunction with the District’s financial statements, which immediately follow this section.

FINANCIAL OVERVIEW

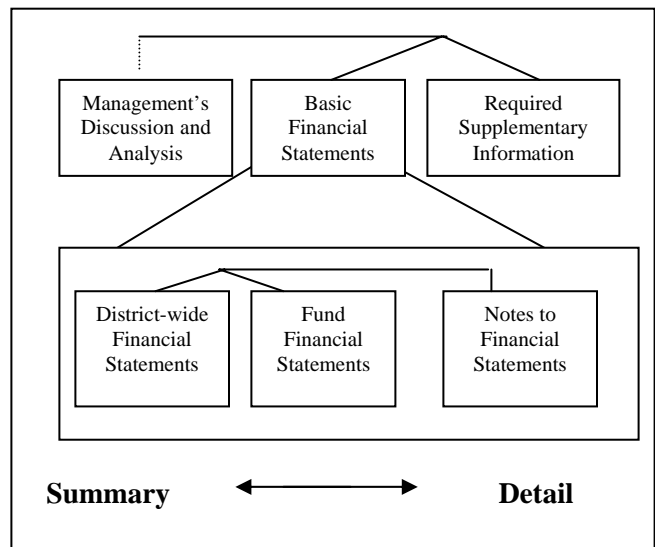
The District’s general fund financial situation did improve from the 2006 fiscal year to 2007. This is the first year in four years in which the general fund did show improvement. For the 2006/2007 school year general fund, fund equity was increased by \$610,772. The Board of Education initially approved a budget with a surplus of \$143,100.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of three parts - management’s discussion and analysis (this section), the basic financial statements and required supplementary information. The basic financial statements include two kinds of statements that present different views of the District:

- The first two statements are district-wide financial statements that provide both short-term and long-term information about the District’s overall financial status.
- The remaining statements are fund financial statements that focus on individual parts of the District, reporting the District’s operations in more detail than the district-wide notes to financial statements.
- The governmental funds statements tell how basic services like instruction and support services were financed in the short-term as well as what remains for future spending.
- Fiduciary funds statements provide information about the financial relationships in which the District acts solely as a trustee or agent for the benefit of others.

**Figure A-1
Organization of Houghton Lake
Community Schools’ Annual Financial**



The financial statements also include notes that explain some of the information in the statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the financial statements with a comparison of the District’s budget for the year. Figure A-1 shows how the various parts of this annual report are arranged and related to one another.

Figure A-2 Major Features of District-Wide and Fund Financial Statements			
	District-wide Statements	Fund Financial Statements	
		Governmental Funds	Fiduciary Funds
Scope	Entire district (except fiduciary funds)	The activities of the district that are not proprietary or fiduciary, such as special education and building maintenance.	Instances in which the district administers resources on behalf of someone else, such as scholarship programs and student activities monies
Required financial statements	* Statement of net assets * Statement of activities	* Balance sheet * Statement of revenues, expenditures and changes in fund balances	* Statement of fiduciary net assets * Statement of changes in fiduciary net assets
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, short-term and long-term	Generally assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets or long-term liabilities included	All assets and liabilities, both short-term and long-term, Houghton Lake's funds do not currently contain capital assets, although they can
Type of inflow/outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year, expenditures when goods or services have been received and the related liability is due and payable	All additions and deductions during the year, regardless of when cash is received or paid

Figure A-2 summarized the major features of the District's financial statements, including the portion of the District's activities they cover and the types of information they contain. The remainder of this overview section of management's discussion and analysis highlights the structure and contents of each of the statements.

DISTRICT-WIDE STATEMENTS

The district-wide statements report information about the District as a whole using accounting methods similar to those used by private-sector companies. The statements of net assets include all of the District's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two district-wide statements report the District's net assets and how they have changed. Net assets - the difference between the District's assets and liabilities - are one way to measure the District's financial health or position.

- Over time, increases or decreases in the District's net assets are an indicator of whether its financial position is improving or deteriorating, respectively.
- To assess the overall health of the District, you need to consider additional non-financial factors such as changes in the District's property tax base and the condition of school buildings and other facilities.

In the district-wide financial statements, the District's activities:

- Governmental activities - Most of the District's basic services are included here, such as regular and special education, transportation and administration. Property taxes and state formula aid finance most of these activities.

FUND FINANCIAL STATEMENTS

The fund financial statements provide more detailed information about the District's funds, focusing on its most significant or "major" funds - not the District as a whole. Funds are accounting devices the District uses to keep track of specific sources of funding and spending on particular programs:

- Some funds are required by State law and by bond covenants.
- The District establishes other funds to control and manage money for particular purposes (like repaying debt, and its capital projects fund) or to show that it is properly using certain revenues (like school lunch and athletics).

The District has two kinds of funds:

- Governmental funds - Most of the District's basic services are included in governmental funds, which generally focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs. Because this information does not encompass the additional long-term focus of the district-wide statements, we provide additional information with the governmental funds statements that explain the relationship (or differences) between them.
- Fiduciary funds - The District is the trustee, or fiduciary, for assets that belong to others, such as the scholarship fund and the student activities funds. The District is responsible for ensuring that the assets reported in these funds are used only for their intended purposes and by those to whom the assets belong. We exclude these activities from the district-wide financial statements because the District cannot use these assets to finance its operations.

FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE

Net assets - The District's combined net assets were more on June 30, 2007 than the year before, increasing by \$781,704 to \$2,935,720.

Table A-3		
Houghton Lake Community Schools Net Assets		
	2007	2006
Current assets	\$ 3,248,220	\$ 5,276,109
Capital assets and other	3,842,736	4,109,932
Total assets	7,090,956	9,386,041
Long-term debt outstanding	1,780,179	2,052,466
Other liabilities	2,375,057	5,179,559
Total liabilities	4,155,236	7,232,025
Net assets:		
Invested in capital assets, net of related debt	2,637,373	3,006,519
Restricted for debt service	104,040	10,327
Unrestricted	194,307	(862,830)
Total net assets	\$ 2,935,720	\$ 2,154,016

Table A-4		
Changes in Houghton Lake Community Schools' Net Assets		
	2007	2006
Revenues:		
Program revenues:		
Charges for services	\$ 436,811	\$ 435,680
Federal and state categorical grants	2,720,414	2,641,338
General revenues:		
Property taxes	7,481,294	6,994,342
Investment	231,239	140,707
State aid - unrestricted	5,561,961	6,719,604
Other	285,166	248,418
Total revenues	16,716,885	17,180,089
Expenses:		
Instruction	9,695,322	10,386,556
Support services	5,277,409	6,379,035
Food services	584,442	781,776
Athletics	217,102	237,838
Interest on long-term debt	20,858	21,421
Unallocated depreciation	140,048	169,604
Total expenses	15,935,181	17,976,230
Change in net assets	\$ 781,704	\$ (796,141)

District Governmental Activities

The District's financial condition has come about through a number of areas.

- Proposal A which established the student foundation grant concept, and has increased that amount from \$4,352 per student in 1995 to \$7,085 per student in 2007.
- The District continues to evaluate its operations to balance its general fund activities.
- During the year the District incurred significant turnover in the areas of the Superintendent and the Business Office.

FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS

For the District as a whole its combined fund balance is \$1,153,953 compared to \$509,544 in 2006. The fund balance increased by \$644,409 for the year primarily due to \$610,772 of activity in the general fund.

General Fund and Budget Highlights

During the 2007 fiscal year the original District budget was amended several times to reflect changes which affected the District.

The District incurred significant turnover during the year. An interim Superintendent and interim Business Manager were retained. The final budget was amended to show a current year balance of \$361,664 while the actual fund balance for the year was \$810,655.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The District's capital assets are as follows:

Table A-5				
Houghton Lake Community Schools' Capital Assets				
	2007			2006
	Cost	Accumulated depreciation	Net book value	Net book value
Land	\$ -	\$ -	\$ -	\$ -
Construction in progress	-	-	-	93,974
Buildings and improvements	11,497,212	8,301,993	3,195,219	3,371,917
Machinery and equipment	1,152,258	1,016,600	135,658	82,754
Transportation equipment	1,584,630	1,216,152	368,478	472,066
Total	<u>\$ 14,234,100</u>	<u>\$ 10,534,745</u>	<u>\$ 3,699,355</u>	<u>\$ 4,020,711</u>

The original cost of land is not determinable and is recorded at zero.

LONG-TERM DEBT

At year end the District had \$1,943,247 long-term debt outstanding as shown in Table A-6. More detailed information is available in Note 7 to the financial statements.

Table A-6		
Houghton Lake Community Schools		
Outstanding Long-Term Debt		
	2007	2006
QZAB bonds	\$ 1,000,000	\$ 1,000,000
Notes payable	204,274	302,152
Compensated absences and termination benefits	738,973	1,065,192
	<u>\$ 1,943,247</u>	<u>\$ 2,367,344</u>

FACTORS BEARING ON THE DISTRICT'S FUTURE

At the time these financial statements were prepared and audited, the District was aware of three existing circumstances that could significantly affect its financial health in the future:

- Since the 2007-2008 foundation allowance has yet to be determined, the District deemed it prudent to base the foundation grant for 2007-2008 at the same level (\$7,085) as in 2006-2007.
- Health care costs continue to increase. The District's employees have agreed to significant cost sharing of health insurance premiums thereby reducing the impact of health insurance cost increase in future years.
- Impact of declining enrollment. The 2006-2007 enrollment declined by 117 pupils or 5.9% representing a loss of \$828,900 in foundation grants. The declining enrollment trend is expected to continue in the future with an additional loss of 134 pupils projected for 2007-2008.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers and investors and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions about this report or need additional information, contact the Business Office, Houghton Lake Community Schools, 6001 W. Houghton Lake Drive, Houghton Lake, Michigan 48629.

HOUGHTON LAKE COMMUNITY SCHOOLS
STATEMENT OF NET ASSETS
JUNE 30, 2007

	<u>Governmental activities</u>
ASSETS	
CURRENT ASSETS:	
Cash	\$ 938,994
Investments	658,619
Receivables:	
Other governmental units	1,362,077
Interest income	28,930
Inventories	2,261
Prepaid expenditures	257,339
TOTAL CURRENT ASSETS	<u>3,248,220</u>
NONCURRENT ASSETS:	
Cash - restricted for debt service set- aside	762
Investments - restricted for debt service set - aside	110,119
Capital assets	14,234,100
Less accumulated depreciation	(10,534,745)
Deferred charges net of amortization	32,500
TOTAL NONCURRENT ASSETS	<u>3,842,736</u>
TOTAL ASSETS	<u><u>\$ 7,090,956</u></u>
LIABILITIES AND NET ASSETS	
CURRENT LIABILITIES:	
Accounts payable	\$ 322,929
Accrued interest payable	6,841
Accrued salaries and related items	760,806
Deferred revenue	126,413
Notes payable	995,000
Current portion of long-term obligations	51,068
Current portion of severance and termination benefits	65,000
Current portion of compensated absences	47,000
TOTAL CURRENT LIABILITIES	<u>2,375,057</u>
NONCURRENT LIABILITIES:	
Noncurrent portion of long-term obligations	1,153,206
Noncurrent severance and termination benefits	175,897
Noncurrent compensated absences	451,076
TOTAL NONCURRENT LIABILITIES	<u>1,780,179</u>
TOTAL LIABILITIES	<u>4,155,236</u>
NET ASSETS:	
Invested in capital assets, net of related debt	2,637,373
Restricted - debt service	104,040
Unrestricted	194,307
TOTAL NET ASSETS	<u>2,935,720</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 7,090,956</u></u>

HOUGHTON LAKE COMMUNITY SCHOOLS
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2007

Functions/programs	Expenses	Program revenues		Governmental activities
		Charges for services	Operating grants	Net (expense) revenue and changes in net assets
Governmental activities:				
Instruction	\$ 9,695,322	\$	\$ 1,852,714	\$ (7,842,608)
Support services	5,277,409	36,592	361,034	(4,879,783)
Food services	584,442	203,908	506,666	126,132
Athletics	217,102	196,311		(20,791)
Interest on long-term debt	20,858			(20,858)
Unallocated depreciation	140,048			(140,048)
Total governmental activities	<u>\$ 15,935,181</u>	<u>\$ 436,811</u>	<u>\$ 2,720,414</u>	<u>(12,777,956)</u>
General revenues:				
Property taxes, levied for general purposes				7,481,294
Investment earnings				231,239
State sources				5,561,961
Other				<u>285,166</u>
Total general revenues				<u>13,559,660</u>
CHANGE IN NET ASSETS				781,704
NET ASSETS , beginning of year				<u>2,154,016</u>
NET ASSETS , end of year				<u>\$ 2,935,720</u>

HOUGHTON LAKE COMMUNITY SCHOOLS
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2007

	General fund	Other nonmajor governmental funds	Total governmental funds
ASSETS			
ASSETS:			
Cash	\$ 591,561	\$ 347,433	\$ 938,994
Investments	658,619		658,619
Receivables:			
Other governmental units	1,362,077		1,362,077
Accounts receivable	8,116	20,814	28,930
Due from other funds	10,283	38,973	49,256
Inventories		2,261	2,261
Prepaid expenditures	257,339		257,339
Cash - restricted for debt service set- aside		762	762
Investments - restricted for debt service set-aside		110,119	110,119
TOTAL ASSETS	\$ 2,887,995	\$ 520,362	\$ 3,408,357
LIABILITIES AND FUND BALANCES			
LIABILITIES:			
Accounts payable	\$ 195,121	\$ 127,808	\$ 322,929
Accrued salaries and related items	760,806		760,806
Deferred revenue	126,413		126,413
Due to other funds		49,256	49,256
Notes payable	995,000		995,000
TOTAL LIABILITIES	2,077,340	177,064	2,254,404

	General fund	Other nonmajor governmental funds	Total governmental funds
FUND BALANCES:			
Reserved for debt service	\$	\$ 110,881	\$ 110,881
Reserved for prepaid expenditures	257,339		257,339
Reserved for inventories		2,261	2,261
Reserved for capital projects		109,792	109,792
Designated for termination benefits	45,000		45,000
Designated for repairs and maintenance	119,246		119,246
Undesignated	389,070	120,364	509,434
TOTAL FUND BALANCES	810,655	343,298	1,153,953
TOTAL LIABILITIES AND FUND BALANCES	\$ 2,887,995	\$ 520,362	\$ 3,408,357
Total governmental fund balance			\$ 1,153,953
Amounts reported for governmental activities in the statement of net assets are different because:			
Capital assets used in governmental activities are not financial resources and are not reported in the funds:			
The cost of the capital assets is		\$ 14,234,100	
Accumulated depreciation is		(10,534,745)	
			3,699,355
The value of unamortized bond issuance costs		37,500	
Accumulated amortization		(5,000)	
			32,500
Long-term liabilities are not due and payable in the current period and are not reported in the funds:			
Accrued severance and termination benefits			(240,897)
Bonds payable and unamortized premium			(1,204,274)
Compensated absences			(498,076)
Accrued interest is not included as a liability in government funds, it is recorded when paid			(6,841)
Net assets of governmental activities			\$ 2,935,720

**HOUGHTON LAKE COMMUNITY SCHOOLS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
YEAR ENDED JUNE 30, 2007**

	General fund	Other nonmajor governmental funds	Total governmental funds
REVENUES:			
Local sources:			
Property taxes	\$ 7,481,294	\$	\$ 7,481,294
Community services and tuition	36,592		36,592
Investment income	220,775	10,464	231,239
Other	165,392	400,219	565,611
Total local sources	7,904,053	410,683	8,314,736
State sources	6,623,637	68,526	6,692,163
Federal sources	1,152,072	438,140	1,590,212
Incoming transfers and other transactions	119,774		119,774
Total revenues	15,799,536	917,349	16,716,885
EXPENDITURES:			
Current:			
Instruction	9,697,301		9,697,301
Support services	5,309,364		5,309,364
Athletics		210,977	210,977
Food service		584,442	584,442
EXPENDITURES (Concluded):			
Current (Concluded):			
Capital outlay and major repairs	\$	\$ 151,656	\$ 151,656
Debt service:			
Payments on debt	97,504		97,504
Interest and fiscal charges	11,232	10,000	21,232
Total expenditures	15,115,401	957,075	16,072,476
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	684,135	(39,726)	644,409
OTHER FINANCING SOURCES (USES):			
Operating transfers in		73,363	73,363
Operating transfers out	(73,363)		(73,363)
Total other financing sources (uses)	(73,363)	73,363	
NET CHANGE IN FUND BALANCES	610,772	33,637	644,409
FUND BALANCES:			
Beginning of year	199,883	309,661	509,544
End of year	\$ 810,655	\$ 343,298	\$ 1,153,953

**HOUGHTON LAKE COMMUNITY SCHOOLS
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2007**

Net change in fund balances total governmental funds	\$ 644,409
Amounts reported for governmental activities in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures. In the statement of activities these costs are allocated over their estimated useful lives as depreciation.	
Depreciation expense	(392,602)
Capital outlay	71,246
Accrued interest on bonds is recorded in the statement of activities when incurred; it is not recorded in governmental funds until it is paid:	
Accrued interest payable, beginning of the year	43,894
Accrued interest payable, end of the year	(6,841)
Proceeds and repayments of principal on long-term debt are other financing sources and expenditures in the governmental funds, but not in the statement of activities (where they are additions and reductions of liabilities)	
Repayments of principal on long-term debt	97,878
Amortization expense	(2,500)
Compensated absences are reported on the accrual method in the statement of activities, and recorded as an expenditure when financial resources are used in the governmental funds:	
Accrued compensated absences, beginning of the year	521,753
Accrued compensated absences, end of the year	(498,076)
Accrued severance and termination benefits, beginning of the year	543,440
Accrued severance and termination benefits, end of the year	(240,897)
Change in net assets of governmental activities	<u>\$ 781,704</u>

HOUGHTON LAKE COMMUNITY SCHOOLS
STATEMENT OF FIDUCIARY ASSETS AND LIABILITIES
JUNE 30, 2007

	<u>Agency funds</u>
ASSETS	
Cash	<u><u>\$ 272,469</u></u>
LIABILITIES	
Due to Houghton Lake Community Schools	\$ 8,116
Due to student groups	<u>264,353</u>
	<u>\$ 272,469</u>

HOUGHTON LAKE COMMUNITY SCHOOLS NOTES TO FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the Houghton Lake Community Schools have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the District's accounting policies are described below.

A. Reporting Entity

The Houghton Lake Community Schools (the "District") is governed by the Houghton Lake Community Schools Board of Education (the "Board"), which has responsibility and control over all activities related to public school education within the District. The District receives funding from local, state, and federal government sources and must comply with all of the requirements of these funding source entities. However, the District is not included in any other governmental reporting entity as defined by accounting principles generally accepted in the United States of America. Board members are elected by the public and have decision-making authority, the power to designate management, the ability to significantly influence operations, and the primary accountability for fiscal matters. The District's reporting entity contains no significant component units as defined in GASB Statements No. 14 and 39.

B. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the District. For the most part, the effect of interfund activity has been removed from these statements. The government-wide financial statements categorize primary activities as either governmental or business type. All of the District's activities are classified as governmental activities.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges paid by recipients who purchase, use or directly benefit from goods or services by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. State Foundation Aid, certain revenue from the intermediate school district and other unrestricted items are not included as program revenues but instead as *general revenues*.

In the government-wide statement of net assets, the governmental activities column (a) is presented on a consolidated basis, (b) and is reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. The District's net assets are reported in three parts - invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets.

The District first utilizes restricted resources to finance qualifying activities.

HOUGHTON LAKE COMMUNITY SCHOOLS NOTES TO FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Government-wide and Fund Financial Statements (Continued)

The government-wide statement of activities reports both the gross and net cost of each of the District's functions. The functions are also supported by general government revenues (property taxes, certain intergovernmental revenues, investment income and other revenue). The statement of activities reduces gross expenses by related program revenues and operating grants. Program revenues must be directly associated with the function. Operating grants include operating-specific and discretionary (either operating or capital) grants.

The net costs (by function) are normally covered by general revenue (property taxes, state sources, intermediate district sources, interest income and other revenues.)

The District does not allocate indirect costs.

This government-wide focus is more on the sustainability of the District as an entity and the change in the District's net assets resulting from the current year's activities.

Separate financial statements are provided for governmental funds and fiduciary funds, even though the latter are excluded from government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

Governmental Funds - Governmental funds are those funds through which most school district functions typically are financed. The acquisition, use and balances of the school district's expendable financial resources and the related current liabilities are accounted for through governmental funds.

The District reports the following major governmental fund:

The *general fund* is the District's primary operating fund. It accounts for all financial resources of the District, except those required to be accounted for in another fund.

Other Non-major Funds

The *special revenue funds* account for revenue sources that are legally restricted to expenditures for specific purposes (not including expendable trusts or major capital projects). The District accounts for its food service and athletic activities in the special revenue funds.

The *debt service fund* accounts for the resources accumulated and payments for principal and interest on long-term general obligation debt of governmental funds.

The *capital projects fund* accounts for the receipt of the QZAB bond proceeds and the acquisition of fixed assets or construction of capital projects.

HOUGHTON LAKE COMMUNITY SCHOOLS NOTES TO FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Government-wide and Fund Financial Statements (Concluded)

Other Non-major Funds (Concluded)

The *fiduciary funds* account for assets held by the District in a trustee capacity or as an agent on behalf of others. Trust funds account for assets held by the District under the terms of a formal trust agreement. Fiduciary funds are not included in the government-wide statements.

The *agency fund* is custodial in nature and does not present results of operations or have a measurement focus. Agency funds are accounted for using the accrual basis of accounting. This fund is used to account for assets that the District holds for others in an agency capacity (primarily student activities).

Accrual Method

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Government Accounting Standards Board.

Modified Accrual Method

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the District considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, state and federal aid and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the District.

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. Measurement Focus, Basis of Accounting and Basis of Presentation

State Revenue

The State of Michigan utilizes a foundation grant approach which provides for a specific annual amount of revenue per pupil based on a statewide formula. The Foundation is funded from state and local sources. Revenues from state sources are primarily governed by the School Aid Act and the School Code of Michigan. The Michigan Department of Education administers the allocation of state funds to school districts based on information supplied by the districts. For the year ended June 30, 2007, the foundation allowance was based on pupil membership counts taken in February and September of 2006.

The state portion of the foundation is provided primarily by a state education property tax millage of 6 mills and an allocated portion of state sales and other taxes. The local portion of the foundation is funded primarily by non-homestead property taxes which may be levied at a rate of up to 18 mills. The State revenue is recognized during the foundation period and is funded through payments from October 2006 to August 2007. Thus, the unpaid portion at June 30th is reported as due from other governmental units.

The District also receives revenue from the state to administer certain categorical education programs. State rules require that revenue earmarked for these programs be used for its specific purpose. Categorical funds received, which are not expended by the close of the fiscal year are recorded as deferred revenue. Other categorical funding is recognized when appropriation is received.

For the year ended June 30, 2007, approximately \$179,000 of non cash transactions from the Michigan Department of Education (MDE) has been recorded as state aid revenue and pension expenditures as a result of a change in funding by the MDE.

D. Other Accounting Policies

1. Cash and equivalents include amounts in demand deposits and certificates of deposit.

The District reports its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* and No. 40, *Deposits and Investment Risk Disclosures*. Under these standards, certain investments are valued at fair value as determined by quoted market prices, or by estimated fair values when quoted market prices are not available. The standards also provide that certain investments are valued at cost (or amortized cost) when they are of a short-term duration, the rate of return is fixed, and the district intends to hold the investment until maturity. Accordingly, investments in banker acceptances and commercial paper are recorded at amortized cost.

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. Measurement Focus, Basis of Accounting and Basis of Presentation (Concluded)

D. Other Accounting Policies (Continued)

1. Cash and equivalents include amounts in demand deposits and certificates of deposit (Concluded)

State statutes authorize the District to invest in bonds and other direct and certain indirect obligations of the U.S. Treasury; certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank, savings and loan association, or credit union, which is a member of the Federal Deposit Insurance Corporation, Federal Savings and Loan Insurance Corporation, or National Credit Union Administration, respectively; in commercial paper rated at the time of purchase within the three highest classifications established by not less than two standard rating services and which matures not more than 270 days after the date of purchase. The District is also authorized to invest in U.S. Government or federal agency obligation repurchase agreements, bankers' acceptances of U.S. banks, and mutual funds composed of investments as outlined above.

2. Property Taxes

Property taxes levied by the District are collected by various municipalities and periodically remitted to the District. The taxes are levied and become a lien as of July 1 and December 1 and are due upon receipt of the billing by the taxpayer and become a lien on the first day of the levy year. The actual due dates are September 14 and February 14, after which time the bills become delinquent and penalties and interest may be assessed by the collecting entity.

For the year ended June 30, 2007, the District levied the following amounts per \$1,000 of assessed valuation:

Fund	Mills
General Fund - Non-homestead	18.0000

3. Inventories and Prepaid Expenditures

Inventories are valued at the lower of cost (first-in, first-out) or market. Inventories consisting of expendable supplies held for consumption, are recorded as expenditures when consumed rather than when purchased. Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenditures.

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Other Accounting Policies (Continued)

4. Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the noncurrent portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds."

All receivables, including property taxes receivable, are shown net of an allowance for uncollectibles.

5. Capital Assets

Capital assets purchased or acquired are capitalized at historical cost or estimated historical cost. Donated fixed assets are valued at their estimated fair market value on the date received.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related capital assets.

Depreciation on all assets is provided on the straight-line basis over the estimated useful lives as follows:

Buildings and additions	50 years
Furniture and other equipment	5 - 20 years
Land improvement	20 years
Transportation equipment	8 years

The District's capitalization policy is to capitalize individual amounts exceeding \$5,000.

6. Compensated Absences

The District's contracts generally provide for granting vacation, sick leave with pay and contain termination incentives. The current and long-term liability for compensated absences is reported on the government-wide financial statements. A liability for these amounts, including related benefits, is reported in governmental funds only if they have matured, for example, as a result of employee leave, resignations or retirements upon the legally enforceable due date.

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Concluded)

D. Other Accounting Policies (Concluded)

7. Long-term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities on the statement of net assets. Bond premiums and discounts, as well as issuance costs and the difference between the reacquisition price and the net carrying amount of the old debt, are deferred and amortized over the life of the bonds using the straight-line method over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

8. Use of Estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenditures. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

NOTE 2 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America. Annual appropriated budgets are adopted for the general and special revenue funds. Encumbrance accounting is employed in governmental funds. Significant encumbrances outstanding at year end, if any, are reported as reservations of fund balance because they will be re-appropriated in the subsequent fiscal year.

The District follows these procedures in establishing the budgetary data reflected in the financial statements:

1. The Superintendent submits to the School Board a proposed operating budget for the fiscal year commencing on July 1. The operating budget includes proposed expenditures and the means of financing them. The level of control for the budgets is at the functional level as set forth and presented as required supplementary information.

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS**

NOTE 2 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY (Concluded)

2. Public hearings are conducted to obtain taxpayer comments.
3. Prior to July 1, the budget is legally adopted by School Board resolution pursuant to the Uniform Budgeting and Accounting Act (1968 PA 2). The Act requires that the budget be amended prior to the end of the fiscal year when necessary to adjust appropriations if it appears that revenues and other financing sources will be less than anticipated or so that expenditures will not be in excess of original estimates. Expenditures shall not be made or incurred, unless authorized in the budget, in excess of the amount appropriated. Violations, if any, in the general fund are noted in the required supplementary information section.
4. The Superintendent is authorized to transfer budgeted amounts between major expenditure functions within any fund; however, these transfers and any revisions that alter the total expenditures of any fund must be approved by the School Board.
5. Formal budgetary integration is employed as a management control device during the year for the general, special revenue, debt service and capital projects funds.
6. The budget was amended during the year with supplemental appropriations, the last one approved prior to June 30, 2007. The District does not consider these amendments to be significant.

NOTE 3 - DEPOSITS AND INVESTMENTS - CREDIT RISK

As of June 30, 2007, the District had the following investments.

<u>Investment type</u>	<u>Fair value</u>	<u>Weighted average maturity (years)</u>	<u>Standard & Poor's rating</u>	<u>%</u>
MILAF External Investment pool - MIMAX	<u>\$ 658,619</u>	0.0027	AAAm	<u>100.00%</u>
Total fair value	<u><u>\$ 658,619</u></u>			<u><u>100.00%</u></u>
Portfolio weighted average maturity		<u><u>0.0027</u></u>		
1 day maturity equals 0.0027, one year equals 1.00				

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS**

NOTE 3 - DEPOSITS AND INVESTMENTS - CREDIT RISK (Continued)

The District voluntarily invests certain excess funds in external pooled investment funds which included money market funds. One of the pooled investment funds utilized by the District is the Michigan Investment Liquid Asset Fund (MILAF). MILAF is an external pooled investment fund of “qualified” investments for Michigan school districts. MILAF is not regulated nor is it registered with the SEC. MILAF reports as of June 30, 2007, the fair value of the District’s investments is the same as the value of the pool shares.

Interest rate risk. In accordance with its investment policy, the District will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by; structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities in the open market; and, investing operating funds primarily in shorter-term securities, liquid asset funds, money market mutual funds, or similar investment pools and limiting the average maturity in accordance with the District’s cash requirements.

Credit risk. State law limits investments in commercial paper and corporate bonds to a prime or better rating issued by nationally recognized statistical rating organizations (NRSROs).

Concentration of credit risk. The District will minimize concentration of credit risk, which is the risk of loss attributed to the magnitude of the District’s investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized.

Custodial credit risk - deposits. In the case of deposits, this is the risk that in the event of a bank failure, the District’s deposits may not be returned to it. As of June 30, 2007, \$1,196,932 of the District’s bank balance of \$1,396,932 was exposed to custodial credit risk because it was uninsured and uncollateralized. The carrying amount is \$1,322,344.

Custodial credit risk - investments. For an investment, this is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

The District will minimize custodial credit risk, which is the risk of loss due to the failure of the security issuer or backer, by; limiting investments to the types of securities allowed by law; and pre-qualifying the financial institutions, broker/dealers, intermediaries and advisors with which the District will do business.

Foreign currency risk. The District is not authorized to invest in investments which have this type of risk.

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS**

NOTE 3 - DEPOSITS AND INVESTMENTS - CREDIT RISK (Concluded)

The above amounts are previously reported in Note 3:

Deposits	\$ 1,322,344
Investments	658,619
	<u>\$ 1,980,963</u>

The above amounts are reported in the financial statements as follows:

Cash - district-wide restricted	\$ 762
Cash - district-wide	938,994
Cash - agency fund	272,469
Investments - unrestricted	658,619
Investments - restricted	110,119
	<u>\$ 1,980,963</u>

NOTE 4 - RECEIVABLES

Receivables from governmental units at June 30, 2007 consist of the following:

	<u>General fund</u>
Other governmental units:	
State aid	\$ 1,046,323
Federal revenue	293,329
Other	22,425
	<u>\$ 1,362,077</u>

HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS

NOTE 5 - CAPITAL ASSETS

A summary of changes in the District's capital assets follows:

	Balance July 1, 2006	Additions	Deletions	Balance June 30, 2007
Governmental activities:				
Capital assets, not being depreciated:	\$	\$	\$	\$
Construction in progress	93,974		(93,974)	
Total capital assets, not being depreciated	93,974		(93,974)	
Capital assets, being depreciated				
Site improvements	245,168			245,168
Buildings and improvements	11,158,070	93,974		11,252,044
Machinery and equipment	1,081,012	71,246		1,152,258
Transportation equipment	1,770,883		186,253	1,584,630
Total capital assets, being depreciated	14,255,133	165,220	186,253	14,234,100
Accumulated depreciation:				
Land improvements	179,549	4,233		183,782
Buildings and additions	7,851,772	266,439		8,118,211
Machinery and equipment	998,258	18,342		1,016,600
Transportation equipment	1,298,817	103,588	186,253	1,216,152
Total accumulated depreciation	10,328,396	392,602	186,253	10,534,745
Net capital assets being depreciated	3,926,737	(227,382)		3,699,355
Net governmental capital assets	\$ 4,020,711	\$ (227,382)	\$ (93,974)	\$ 3,699,355

Depreciation for the fiscal year ended June 30, 2007 amounted to \$392,602. The District allocated depreciation expense to the various activities as follows:

Instruction	\$ 243,831
Support services	2,598
Athletics	6,125
Unallocated	140,048
	<u>\$ 392,602</u>

Depreciation of capital assets that serve multiple functions is recorded as unallocated. Original cost of land is not determinable and is recorded at zero.

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS**

NOTE 6 - NOTES PAYABLE

At June 30, 2007, the District has a note payable outstanding of \$995,000. The tax anticipation note of \$995,000 has an interest rate of 3.98% and matures March 27, 2008. The note is secured by the full faith and credit of the District as well as pledged property taxes.

Balance June 30, 2006	Additions	Payments	Balance June 30, 2007
\$ 4,000,000	\$ 995,000	\$ 4,000,000	\$ 995,000

NOTE 7 - LONG-TERM DEBT

The District may issue general obligation bonds to provide funds for the acquisition, construction and improvement of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the District. Long-term obligations currently outstanding are as follows:

The following is a summary of the long-term debt transactions of the District for the year end June 30, 2007:

	Notes payable	QZAB bonds	Sub-total bonded & notes	Voluntary termination benefits	Compensated absences	Severance benefits	Total
Balance, July 1, 2006	\$ 302,152	\$ 1,000,000	\$ 1,302,152	\$ 245,000	\$ 521,752	\$ 298,440	\$ 2,367,344
Deletions	97,878		97,878	200,000	23,676	102,543	424,097
Balance, June 30, 2007	204,274	1,000,000	1,204,274	45,000	498,076	195,897	1,943,247
Less current portion	51,068		51,068	45,000	47,000	20,000	163,068
Total due after one year	\$ 153,206	\$ 1,000,000	\$ 1,153,206	\$ -	\$ 451,076	\$ 175,897	\$ 1,780,179

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS**

NOTE 7 - LONG-TERM DEBT (Continued)

Long-term obligation debt at June 30, 2007 is comprised of the following:

2005 School Building Bond is due in one installment on June 21, 2021. The bond was issued under the Qualified Zone Academy Bond program. Interest is reduced to 1.00% through a tax credit. A set-aside amount of \$64,684 is required each year. Interest of 2.75% will be earned on the set-aside account.		<u>\$ 1,000,000</u>
Total bonded debt		1,000,000
Chase Bank note for purchase of a bus with annual payments of \$51,068 to \$51,070 through October 21, 2011, at 4.02% interest rate.		204,274
Obligation under contract from compensated absences		498,076
Voluntary termination benefits		45,000
Obligation under contract from severance incentives		<u>195,897</u>
Total long-term debt		<u><u>\$ 1,943,247</u></u>

Interest expense (all funds) for the year ended June 30, 2007 was \$152,912.

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS**

NOTE 7 - LONG-TERM DEBT (Concluded)

The annual requirements to amortize long-term debt outstanding as of June 30, 2007, including interest of \$140,530 are as follows:

Year ending June 30,	Principal	Interest	Total
2008	\$ 51,068	\$ 18,212	\$ 69,280
2009	51,068	16,159	67,227
2010	51,069	14,106	65,175
2011	51,069	12,053	63,122
2012		10,000	10,000
2013 - 2018		50,000	50,000
2019 - 2022	1,000,000	20,000	1,020,000
Total	1,204,274	140,530	1,344,804
Voluntary termination benefits	45,000		45,000
Accumulated compensated absences	498,076		498,076
Accumulated severance benefits	195,897		195,897
	<u>\$ 1,943,247</u>	<u>\$ 140,530</u>	<u>\$ 2,083,777</u>

Voluntary Termination Benefits

The District had entered into voluntary termination benefit arrangements with certain employees. The original agreement provides for a total payment to each individual of \$40,000 for an employee retiring in 2002-03. This amount is paid over four equal payments of \$10,000 annually. The agreement also provides that any teacher retiring in 2003-04 and 2004-05 shall receive \$35,000. This amount is to be paid in three payments of \$10,000, \$10,000, and \$15,000 annually. There are currently three employees entitled to future payments. The liability has been recorded at the face amount, plus accrued FICA, as the discounted present value approximates face amount of the liability. The legally enforceable due date for payment is July 1. Amounts due July 1 (\$45,000) are not accrued as a liability in the general fund.

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO FINANCIAL STATEMENTS**

NOTE 8 - INTERFUND RECEIVABLES AND PAYABLES

Interfund payable and receivable balances at June 30, 2007 are as follows:

Receivable fund		Payable fund	
General	\$ 10,283	Athletic fund	\$ 43,878
School lunch fund	38,973	Capital Projects Fund	5,378
	<u>\$ 49,256</u>		<u>\$ 49,256</u>

The outstanding balances between funds result mainly from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in accounting systems, and (3) payments between funds are made.

NOTE 9 - EMPLOYEE RETIREMENT SYSTEM - DEFINED BENEFIT PLAN

Plan Description - The District contributes to the statewide Michigan Public School Employees' Retirement System (MPERS), a cost sharing multiple-employer state-wide defined benefit public employee retirement plan governed by the State of Michigan. The MPERS provides retirement survivor and disability benefits and postretirement benefits for health, dental and vision for substantially all employees of the District. The MPERS was established by Public Act 136 of 1945 and operated under the provisions of Public Act 300 of 1980, as amended. The MPERS issues a publicly available financial report that includes financial statements and required supplementary information for MPERS. That report may be obtained by writing to Michigan Public School Employees Retirement System, P.O. Box 30171, Lansing, Michigan 48909-7671 or by calling (800) 381-5111.

Funding Policy - Member Investment Plan (MIP) members enrolled in MIP prior to January 1, 1990 contribute a permanently fixed rate of 3.9% of gross wages. The MIP contribution rate was 4.0% from January 1, 1987, the effective date of the MIP, until January 1, 1990 when it was reduced to 3.9%. Members first hired January 1, 1990 or later and returning members who did not work between January 1, 1987 through December 31, 1989 contribute at the following graduated permanently fixed contribution rate: 3% of the first \$5,000; 3.6% of \$5,001 through \$15,000; 4.3% of all wages over \$15,000.

Basic Plan members make no contributions. For a limited period ending December 31, 1992, an active Basic Plan member could enroll in the MIP by paying the contributions that would have been made had enrollment occurred initially on January 1, 1987 or on the date of hire, plus interest. MIP contributions at the rate of 3.9% of gross wages begin at enrollment. Actuarial rate interest is posted to member accounts on July 1st on all MIP monies on deposit for 12 months. If a member leaves MPERS service and no pension is payable, the member's accumulated contribution plus interest, if any, are refundable.

HOUGHTON LAKE COMMUNITY SCHOOLS NOTES TO FINANCIAL STATEMENTS

NOTE 9 - EMPLOYEE RETIREMENT SYSTEM - DEFINED BENEFIT PLAN (Concluded)

The District is required to contribute the full actuarial funding contribution amount to fund pension benefits, plus an additional amount to fund retiree health care benefit amounts on a cash disbursement basis. The rates for the year ended June 30, 2007 were 16.34% of payroll through September 30, 2006 and 17.74% effective October 1, 2006 through June 30, 2007. The contribution requirements of plan members and the District are established and may be amended by the MPSERS Board of Trustees. The District contributions to MPSERS for the year ended June 30, 2007, 2006 and 2005 were approximately \$1,480,000, \$1,578,000 and \$1,530,000, respectively, and were equal to the required contribution for those years.

Other Post-employment Benefits - Retirees have the option of health coverage, which is funded on a cash disbursement basis by the employers. The System has contracted to provide the comprehensive group medical, hearing, dental and vision coverages for retirees and beneficiaries. A significant portion of the premiums is paid by the System with the balance deducted from the monthly pension.

The District is not responsible for the payment of retirement benefits or other post-employment benefits which is the responsibility of the State of Michigan.

NOTE 10 - RISK MANAGEMENT

The District is exposed to various risk of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees' and natural disasters. The District participates in a distinct pool of educational institutions within the State of Michigan for self-insuring workers' disability compensation. The pool is considered a public entity risk pool. The District pays annual premiums to the pool for the respective insurance coverage. In the event the pool's total claims and expenses for a policy year exceed the total normal annual premiums for said years, all members of the specific pool's policy year may be subject to special assessment to make up the deficiency. The pool maintains reinsurance for claims in excess of \$500,000 for each occurrence with the overall maximum coverage being unlimited. The District has not been informed of any special assessments being required.

The District continues to carry commercial insurance for other risks of loss, including property and casualty errors and omissions, fleet and employee health and accident insurance.

NOTE 11 - TRANSFERS

The general fund transferred \$64,684 to the QZAB debt service fund to fund the required set aside funding requirement and \$8,679 to the Athletic Fund to eliminate the deficit in this fund.

REQUIRED SUPPLEMENTARY INFORMATION

**HOUGHTON LAKE COMMUNITY SCHOOLS
REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
YEAR ENDED JUNE 30, 2007**

	Original budget	Final budget	Actual	Variance with final budget positive (negative)
REVENUES:				
Local	\$ 7,662,000	\$ 7,895,400	\$ 7,904,053	\$ 8,653
State sources	6,670,600	6,762,760	6,623,637	(139,123)
Federal sources	1,211,000	1,263,781	1,152,072	(111,709)
Incoming transfers and other transactions	91,000	123,200	119,774	(3,426)
Total revenues	15,634,600	16,045,141	15,799,536	(245,605)
EXPENDITURES:				
Current:				
Instruction:				
Basic programs	7,197,000	7,451,031	7,476,929	(25,898)
Added needs	2,593,400	2,453,705	2,220,372	233,333
Total instruction	9,790,400	9,904,736	9,697,301	207,435
Support services:				
Pupil	978,800	983,853	947,538	36,315
Instructional staff	357,350	446,291	366,805	79,486
General administration	433,000	360,800	373,347	(12,547)
School administration	957,000	965,784	928,000	37,784
Technology services	145,000	161,080	169,106	(8,026)
Business	510,450	543,476	501,763	41,713
Operations/maintenance	1,337,600	1,292,297	1,272,299	19,998
Transportation	815,000	851,576	750,506	101,070
Total support services	5,534,200	5,605,157	5,309,364	295,793
Debt service	166,900	173,584	108,736	64,848
Total expenditures	15,491,500	15,683,477	15,115,401	568,076
EXCESS OF REVENUES OVER EXPENDITURES	143,100	361,664	684,135	322,471
OTHER FINANCING SOURCES (USES):				
Operating transfers out			(73,363)	(73,363)
NET CHANGE IN FUND BALANCE	<u>\$ 143,100</u>	<u>\$ 361,664</u>	610,772	<u>\$ 249,108</u>
FUND BALANCE:				
Beginning of year			199,883	
End of year			<u>\$ 810,655</u>	

ADDITIONAL INFORMATION

**HOUGHTON LAKE COMMUNITY SCHOOLS
COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUND TYPES
JUNE 30, 2007**

	<u>Special revenue</u>	<u>QZAB debt service</u>	<u>Capital projects</u>	<u>Total nonmajor governmental funds</u>
ASSETS				
ASSETS:				
Cash	\$ 232,263		\$ 115,170	\$ 347,433
Cash - restriced for debt service set-aside		762		762
Investments - restricted for debt service set-aside		110,119		110,119
Receivables:				
Accounts receivable	20,814			20,814
Due from other funds	38,973			38,973
Inventories	2,261			2,261
TOTAL ASSETS	<u><u>\$ 294,311</u></u>	<u><u>\$ 110,881</u></u>	<u><u>\$ 115,170</u></u>	<u><u>\$ 520,362</u></u>
LIABILITIES AND FUND BALANCES				
LIABILITIES:				
Accounts payable	\$ 127,808	\$	\$	\$ 127,808
Due to other funds	43,878		5,378	49,256
TOTAL LIABILITIES	<u>171,686</u>		<u>5,378</u>	<u>177,064</u>
FUND BALANCES:				
Reserved for debt service		110,881		110,881
Reserved for inventories	2,261			2,261
Reserved for capital projects			109,792	109,792
Undesignated	120,364			120,364
TOTAL FUND BALANCES	<u>122,625</u>	<u>110,881</u>	<u>109,792</u>	<u>343,298</u>
TOTAL LIABILITIES AND FUND BALANCES	<u><u>\$ 294,311</u></u>	<u><u>\$ 110,881</u></u>	<u><u>\$ 115,170</u></u>	<u><u>\$ 520,362</u></u>

**HOUGHTON LAKE COMMUNITY SCHOOLS
COMBINING STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
NONMAJOR GOVERNMENTAL FUND TYPES
YEAR ENDED JUNE 30, 2007**

	Special revenue	QZAB debt service	Capital projects	Total nonmajor governmental funds
REVENUES:				
Local sources:				
Investment income	\$	\$ 1,976	\$ 8,488	\$ 10,464
Other	400,219			400,219
Total local sources	400,219	1,976	8,488	410,683
State sources	68,526			68,526
Federal sources	438,140			438,140
Total revenues	906,885	1,976	8,488	917,349
EXPENDITURES:				
Current :				
Athletics	210,977			210,977
Food service	584,442			584,442
Capital outlay			151,656	151,656
Debt service:				
Interest and fiscal charges		10,000		10,000
Total expenditures	795,419	10,000	151,656	957,075
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	111,466	(8,024)	(143,168)	(39,726)
OTHER FINANCING SOURCES:				
Operating transfers in	8,679	64,684		73,363
NET CHANGE IN FUND BALANCES	120,145	56,660	(143,168)	33,637
FUND BALANCES:				
Beginning of year	2,480	54,221	252,960	309,661
End of year	\$ 122,625	\$ 110,881	\$ 109,792	\$ 343,298

**HOUGHTON LAKE COMMUNITY SCHOOLS
SPECIAL REVENUE FUNDS
COMBINING BALANCE SHEET
JUNE 30, 2007
(with comparative totals for June 30, 2006)**

			Totals	
	School lunch fund	Athletics fund	2007	2006
ASSETS				
Cash and investments	\$ 180,730	\$ 51,533	\$ 232,263	\$ 118,619
Accounts receivable	20,814		20,814	46,431
Due from other funds	38,973		38,973	
Inventory	2,261		2,261	2,261
Total assets	<u>\$ 242,778</u>	<u>\$ 51,533</u>	<u>\$ 294,311</u>	<u>\$ 167,311</u>
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	\$ 120,153	\$ 7,655	\$ 127,808	\$ 8,866
Due to other funds		43,878	43,878	155,965
Total liabilities	<u>120,153</u>	<u>51,533</u>	<u>171,686</u>	<u>164,831</u>
Fund balances:				
Reserved for inventories	2,261		2,261	2,261
Undesignated	120,364		120,364	219
Total fund balances	<u>122,625</u>		<u>122,625</u>	<u>2,480</u>
Total liabilities and fund balances	<u>\$ 242,778</u>	<u>\$ 51,533</u>	<u>\$ 294,311</u>	<u>\$ 167,311</u>

**HOUGHTON LAKE COMMUNITY SCHOOLS
SPECIAL REVENUE FUNDS
COMBINING STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
YEAR ENDED JUNE 30, 2007
(with comparative totals for June 30, 2006)**

			Totals	
	School lunch fund	Athletics fund	2007	2006
REVENUES:				
Food service	\$ 203,908	\$	\$ 203,908	\$ 203,015
Athletics		196,311	196,311	203,214
State sources	68,526		68,526	84,093
Federal sources	438,140		438,140	434,966
Total revenues	710,574	196,311	906,885	925,288
EXPENDITURES:				
Salaries and wages	184,822	126,525	311,347	288,508
Employee benefits	18,565	37,687	56,252	264,669
Supplies and other expenses	381,055	46,765	427,820	460,031
Total expenditures	584,442	210,977	795,419	1,013,208
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	126,132	(14,666)	111,466	(87,920)
OTHER FINANCING SOURCES:				
Operating transfer in from general fund		8,679	8,679	20,890
NET CHANGE IN FUND BALANCES	126,132	(5,987)	120,145	(67,030)
FUND BALANCES:				
Beginning of year	(3,507)	5,987	2,480	69,510
End of year	\$ 122,625	\$	\$ 122,625	\$ 2,480

**HOUGHTON LAKE COMMUNITY SCHOOLS
 AGENCY FUNDS
 STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS
 YEAR ENDED JUNE 30, 2007**

	<u>Balance</u> <u>July 1, 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2007</u>
Agency funds - due to student groups	<u>\$ 284,551</u>	<u>\$ 452,481</u>	<u>\$ 472,679</u>	<u>\$ 264,353</u>

**HOUGHTON LAKE COMMUNITY SCHOOLS
GENERAL FUND
SCHEDULE OF REVENUES
YEARS ENDED JUNE 30, 2007 AND 2006**

	<u>2007</u>	<u>2006</u>
REVENUES:		
Local sources:		
Property taxes	\$ 7,450,476	\$ 6,937,004
Delinquent property taxes	2,345	13,291
Penalties on summer tax collection	28,473	44,047
Community education	34,941	24,242
Interest	220,775	123,710
Summer school tuition	1,651	5,209
Other	<u>165,392</u>	<u>196,048</u>
Total local sources	<u>7,904,053</u>	<u>7,343,551</u>
State sources:		
Foundation	5,142,115	6,175,596
At risk	419,846	544,008
Special education	727,148	611,597
Durant settlement		12,212
Early childhood education	105,600	105,600
Other	<u>228,928</u>	<u>121,622</u>
Total state sources	<u>6,623,637</u>	<u>7,570,635</u>
Federal sources:		
Title I - regular	499,767	637,579
Title II	163,252	195,416
Title V	3,429	20,219
Special Education IDEA	359,154	350,876
Special Education Transition Grant		3,450
Adult Basic Education	87,736	48,000
Michigan Rural System Initiative	652	2,432
Drug Free Schools	29,180	3,683
Homeland security grant		6,670
Service provider	600	
Transition grant	2,735	
Career Tech/Vocational	5,490	
Health Day grant	<u>77</u>	<u>2,923</u>
Total federal sources	<u>1,152,072</u>	<u>1,271,248</u>
Interdistrict		
Transportation	4,334	
Other reimbursements	<u>18,936</u>	<u>15,144</u>
Total interdistrict sources	23,270	15,144
Other revenues:		
Special education	<u>96,504</u>	<u>37,226</u>
Total revenues	<u><u>\$ 15,799,536</u></u>	<u><u>\$ 16,237,804</u></u>

HOUGHTON LAKE COMMUNITY SCHOOLS
GENERAL FUND
SCHEDULE OF EXPENDITURES
YEAR ENDED JUNE 30, 2007
(with comparative totals for the year ended June 30, 2006)

	Salaries	Employee benefits	Purchased services	Supplies and materials	Other expenses	Capital outlay	Totals	
							2007	2006
Instruction:								
Elementary	\$ 1,386,118	\$ 823,965	\$ 10,660	\$ 19,633	\$ 45	\$	\$ 2,240,421	\$ 3,107,580
Middle school	1,329,781	710,326	16,333	20,759	1,060	848	2,079,107	1,611,923
High school	1,891,263	961,008	95,878	72,747	4,787	2,347	3,028,030	2,689,295
Preschool	81,629	47,306	376		60		129,371	155,592
Total basic	4,688,791	2,542,605	123,247	113,139	5,952	3,195	7,476,929	7,564,390
Special education	924,419	539,857	10,551	1,882	36,602		1,513,311	1,600,894
Compensatory education	233,577	111,392	40,532	47,756			433,257	1,078,086
Vocational education	9,996	2,532		5,400	49,246		67,174	83,914
Summer School	4,126	4,092		1,332			9,550	
Community Service	1,071		2,285	245			3,601	
Enrichment program		3,098	8,989	16,259			28,346	10,874
Adult basic education	40,379	11,615	2,979	14,426	827	459	70,685	16,837
Lady of the Lakes	4,280	1,087	3,834	18,738			27,939	
Adult secondary education	38,264	16,415	2,446	9,384			66,509	96,137
Total added needs	1,256,112	690,088	71,616	115,422	86,675	459	2,220,372	2,886,742
Total instruction	5,944,903	3,232,693	194,863	228,561	92,627	3,654	9,697,301	10,451,132

HOUGHTON LAKE COMMUNITY SCHOOLS
GENERAL FUND
SCHEDULE OF EXPENDITURES
YEAR ENDED JUNE 30, 2007
(with comparative totals for the year ended June 30, 2006)

	<u>Salaries</u>	<u>Employee benefits</u>	<u>Purchased services</u>	<u>Supplies and materials</u>	<u>Other expenses</u>	<u>Capital outlay</u>	<u>Totals</u>	
							<u>2007</u>	<u>2006</u>
Support services:								
Guidance	\$ 232,587	\$ 100,656	\$	\$	\$	\$	\$ 333,243	\$ 325,839
Responsible Thinking	14,220	18,074	1,632	1,498			35,424	
Health service	66,058	31,087	905		45		98,095	96,328
Psychological services	72,529	32,048					104,577	100,496
Speech and language therapy	129,928	60,828					190,756	191,454
Social worker services	130,418	55,025					185,443	270,155
Total pupil	645,740	297,718	2,537	1,498	45		947,538	984,272
Improvement of instruction	7,162	7,725	63,920	4,288			83,095	75,559
Educational media services	91,675	56,407	9,760	91,944		984	250,770	216,202
Other school administration	10,643	15,218		786	6,293		32,940	98,003
Total instructional staff	109,480	79,350	73,680	97,018	6,293	984	366,805	389,764
Board of education	570		141,742		4,676		146,988	169,306
Executive administration	155,624	54,810	7,162	6,233	2,530		226,359	203,534
Pupil accounting								21,868
Total general administration	156,194	54,810	148,904	6,233	7,206		373,347	394,708

HOUGHTON LAKE COMMUNITY SCHOOLS
GENERAL FUND
SCHEDULE OF EXPENDITURES
YEAR ENDED JUNE 30, 2007
(with comparative totals for the year ended June 30, 2006)

	<u>Salaries</u>	<u>Employee benefits</u>	<u>Purchased services</u>	<u>Supplies and materials</u>	<u>Other expenses</u>	<u>Capital outlay</u>	<u>Totals</u>	
							<u>2007</u>	<u>2006</u>
Support services (Concluded):								
School administration	\$ 628,559	\$ 291,623	\$ 1,451	\$ 2,878	\$ 3,489	\$	\$ 928,000	\$ 1,271,448
Technology services	84,822	43,398	98			40,788	169,106	163,197
Fiscal services	139,584	56,751	88,919		99		285,353	283,902
Internal services	5,296	1,332					6,628	8,764
Other business services			378		209,404		209,782	168,039
Total business	144,880	58,083	89,297		209,503		501,763	460,705
Operation and maintenance	415,603	256,747	477,767	91,955	24,222	6,005	1,272,299	1,512,184
Pupil transportation services	321,143	271,065	15,842	123,915	525	18,016	750,506	1,200,159
Total support services	2,506,421	1,352,794	809,576	323,497	251,283	65,793	5,309,364	6,376,437
Debt service					108,736		108,736	47,684
Total expenditures	<u>\$ 8,451,324</u>	<u>\$ 4,585,487</u>	<u>\$ 1,004,439</u>	<u>\$ 552,058</u>	<u>\$ 452,646</u>	<u>\$ 69,447</u>	<u>\$ 15,115,401</u>	<u>16,875,253</u>

**HOUGHTON LAKECOMMUNITY SCHOOLS
BONDED DEBT
YEAR ENDED JUNE 30, 2007**

2005 Qualified Zone Academy Bonds

Calendar Year	Interest rate	Principal due June 21
2021	1.00%	<u>\$ 1,000,000</u>

The above bonds dated June 21, 2005 were issued for the purpose of financing renovations and improvements to school properties. The amount of the original bond issue was \$1,000,000.

Bonds of this issue are not subject to redemption prior to maturity.

**HOUGHTON LAKE COMMUNITY SCHOOLS
SCHEDULE OF INSTALLMENT NOTE PAYABLE
YEAR ENDED JUNE 30, 2007**

\$255,342 installment notes payable dated October 21, 2005 for bus purchase.

Principal due October 21,	Interest due October 21,	Debt service requirement	
		June 30,	Amount
\$ 51,068	\$ 8,212	2008	\$ 59,280
51,068	6,159	2009	57,227
51,069	4,106	2010	55,175
51,069	2,053	2011	53,122
<u>\$ 204,274</u>	<u>\$ 20,530</u>		<u>\$ 224,804</u>

The above notes have an interest rate of 4.02%.

HOUGHTON LAKE COMMUNITY SCHOOLS

**ADDITIONAL REPORTS REQUIRED BY
OMB CIRCULAR A-133**

YEAR ENDED JUNE 30, 2007

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Timothy J. Orians
Dennis D. Theis

Walter P. Maner, Jr. (1921-2004)
Floyd L. Costerisan
Leon A. Ellis (1933-1988)

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the Board of Education
Houghton Lake Community Schools
Houghton Lake, Michigan

October 8, 2007

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Houghton Lake Community Schools as of and for the year ended June 30, 2007, which collectively comprise Houghton Lake Community Schools' basic financial statements and have issued our report thereon dated October 8, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Houghton Lake Community Schools' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be a significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described as 2007-01, 2007-02, and 2007-03 in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting.

To the Board of Education
Houghton Lake Community Schools
Houghton Lake, Michigan

October 8, 2007

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, the significant deficiencies described above as 2007-01, 2007-02, and 2007-3 we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Houghton Lake Community Schools' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of Houghton Lake Community Schools in a separate letter dated October 8, 2007.

Houghton Lake Community Schools' response to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit Houghton Lake Community Schools' responses and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Education, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Mama, Costeniser & Ellis, P.C.

Certified Public Accountants



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**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND
ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE
WITH OMB CIRCULAR A-133**

To the Board of Directors
Houghton Lake Community Schools
Houghton Lake, Michigan

October 8, 2007

Compliance

We have audited the compliance of Houghton Lake Community Schools with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal programs for the year ended June 30, 2007. Houghton Lake Community Schools' major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal programs is the responsibility of Houghton Lake Community Schools' management. Our responsibility is to express an opinion on Houghton Lake Community Schools' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Houghton Lake Community Schools' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Houghton Lake Community Schools' compliance with those requirements.

In our opinion, Houghton Lake Community Schools complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2007.

Internal Control Over Compliance

The management of Houghton Lake Community Schools is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Houghton Lake Community Schools' internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Entity's internal control over compliance.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

To the Board of Education
Houghton Lake Community Schools
Houghton Lake, Michigan

October 8, 2007

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of Houghton Lake Community Schools as of and for the year ended June 30, 2007, and have issued our report thereon dated October 8, 2007. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise Houghton Lake Community Schools' basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Board of Education, management, federal award agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Mayer, Costeniser & Ellis, P.C.

Certified Public Accountants

**HOUGHTON LAKE COMMUNITY SCHOOLS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2007**

Federal grantor/pass-through grantor program title	Federal CFDA number	Pass-through grantor's number	Award amount	Accrued (deferred) revenue 6/30/2006	Prior year expenditures (memorandum only)	Current year receipts (cash basis)	Current year expenditures	Accrued (deferred) revenue 6/30/2007
<u>U.S. Department of Agriculture:</u>								
Passed through Michigan Department of Education:								
Child nutrition cluster:								
National School Lunch Program - Section 4	10.555	061950	\$ 40,002	\$	35,457	\$ 4,545	\$ 4,545	\$
National School Lunch Program - Section 4		071950	38,847			38,847	38,847	
National School Lunch Program - Section 11		061960	250,725		224,037	26,688	26,688	
National School Lunch Program - Section 11		071960	243,248			231,556	243,248	11,692
			<u>572,822</u>		<u>259,494</u>	<u>301,636</u>	<u>313,328</u>	<u>11,692</u>
National School Lunch Program - Breakfast	10.553	061970	93,999		86,926	7,073	7,073	
National School Lunch Program - Breakfast		071970	89,310			85,309	89,310	4,001
			<u>183,309</u>		<u>86,926</u>	<u>92,382</u>	<u>96,383</u>	<u>4,001</u>
Total child nutrition cluster			<u>756,131</u>		<u>346,420</u>	<u>394,018</u>	<u>409,711</u>	<u>15,693</u>
National School Lunch Program - Commodities: Entitlement	10.550		<u>28,429</u>		<u>30,347</u>	<u>28,429</u>	<u>28,429</u>	
Total U.S. Department of Agriculture			<u>784,560</u>		<u>376,767</u>	<u>422,447</u>	<u>438,140</u>	<u>15,693</u>
<u>National Science Foundation:</u>								
Passed through Western Michigan University: 05-06 Michigan Rural Systemic Initiative	47.076		<u>652</u>		<u>2,432</u>	<u>652</u>	<u>652</u>	

The accompanying notes are an integral part of this schedule.

**HOUGHTON LAKE COMMUNITY SCHOOLS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2007**

Federal grantor/pass-through grantor program title	Federal CFDA number	Pass-through grantor's number	Award amount	Accrued (deferred) revenue 6/30/2006	Prior year expenditures (memorandum only)	Current year receipts (cash basis)	Current year expenditures	Accrued (deferred) revenue 6/30/2007
U.S. Department of Education:								
Passed through C.O.O.R.I.S.D.:								
Special Education Cluster:								
Special Education Flow Through Grant	84.027	060450-0405	\$ 350,876	\$ 176,160	\$ 350,876	\$ 176,160	\$	\$
Special Education Flow Through Grant		060450-0405	359,154			251,652	359,154	107,502
Transition Services Grant		070490/TS	2,735			2,735	2,735	
Total Special Education Cluster			712,765	176,160	350,876	430,547	361,889	107,502
Tech-Prep	84.243	073540/7014-6	5,490			5,490	5,490	
Total C.O.O.R.I.S.D.			718,255	176,160	350,876	436,037	367,379	107,502
Passed through Michigan Department of Education:								
Adult Basic Education								
	84.002	061130-610776	48,000	5,667	48,000	5,667		
		061130-710777	10,000			4,866	9,743	4,877
		071130-710777	47,300			41,586	46,312	4,726
		071190-710777	33,700			16,635	31,681	15,046
Total Adult Basic Education			139,000	5,667	48,000	68,754	87,736	24,649
Title I	84.010	061530-0506	635,499	(33,274)	602,225		33,274	
Title I		061530-0607	18,830			18,830	18,830	
Title I		071530-0607	571,949			357,880	447,663	89,783
Total Title I			1,226,278	(33,274)	602,225	376,710	499,767	89,783
Title II - Improving Teacher Quality	84.367	070520-0607	170,128			100,112	145,525	45,413

The accompanying notes are an integral part of this schedule.

**HOUGHTON LAKE COMMUNITY SCHOOLS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2007**

Federal grantor/pass-through grantor program title	Federal CFDA number	Pass-through grantor's number	Award amount	Accrued (deferred) revenue 6/30/2006	Prior year expenditures (memorandum only)	Current year receipts (cash basis)	Current year expenditures	Accrued (deferred) revenue 6/30/2007
<u>U.S. Department of Education (Concluded):</u>								
Passed through Michigan Department of Education (Concluded):								
Service Provider Self Review	84.027A	070440-0607	\$ 4,500	\$	\$	\$ 600	\$ 600	\$
Title V	84.298	060250-0506	17,547	8,270	17,451	8,270		
Title V		070250-0607	7,637			279	3,429	3,150
Total Title V			25,184	8,270	17,451	8,549	3,429	3,150
Tech Literacy Challenge Grant	84.318	064290-0506	11,856			11,856	11,856	
		074290-0607	5,871			2,725	5,871	3,146
Total Tech Literacy Challenge Grant			17,727			14,581	17,727	3,146
Passed through Cheboygan-Otsego-Presque Isle Educational Service District:								
Drug Free Schools	84.186		39,134	(8,020)		17,168	29,180	3,992
Total Michigan Department of Education			1,621,951	(27,357)	667,676	586,474	783,964	170,133
Total U.S. Department of Education			2,340,206	148,803	1,395,319	1,022,511	1,151,343	277,635
<u>U.S. Department of Health and Human Services:</u>								
Passed through Michigan Department of Education:								
CDC Grant - CSHP Tech Assistant Grant	93.938	052770-ACS0305	2,923	(77)			77	
TOTAL EXPENDITURES OF FEDERAL AWARDS			\$ 3,128,341	\$ 148,726	\$ 1,774,518	\$ 1,445,610	\$ 1,590,212	\$ 293,328

The accompanying notes are an integral part of this schedule.

**HOUGHTON LAKE COMMUNITY SCHOOLS
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2007**

NOTE 1 - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Houghton Lake Community Schools and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The amounts presented in this schedule have been reconciled to the amounts used in the preparation of the financial statements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. (CFDA #84.027) Special Education Cluster, (CFDA #10.553 and #10.555) National School Lunch Cluster, and (CFDA #84.367) Title II were audited as major programs and represents 57% of expenditures.
2. The threshold for distinguishing Type A and B programs was \$300,000.
3. Expenditures on this schedule reconcile with amounts reported in the financial statements and financial reports submitted to the Michigan Department of Education.
4. Management has utilized the Grant Section Auditors' Report (Form R7120) and the Grant Audit Report in preparing the Schedule of Expenditures of Federal Awards.
5. The amounts reported on the Receipt Entitlement Balance Report agree with this schedule for USDA donated food commodities.

NOTE 3 - RECONCILIATION OF FEDERAL REVENUE

Federal expenditures reported as revenue in the following funds in the financial statements.

General fund	\$ 1,152,072
Other non-major governmental funds	<u>438,140</u>
	<u><u>\$ 1,590,212</u></u>

**HOUGHTON LAKE COMMUNITY SCHOOLS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2007**

Section I - Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: *Unqualified*

Internal control over financial reporting:

- Material weakness(es) identified? X Yes No
- Significant deficiency(ies) identified that are not considered to be material weaknesses? Yes X None reported

Noncompliance material to financial statements noted? Yes X No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified: Yes X No
- Significant deficiency(ies) identified that are not considered to be material weakness(es)? Yes X None reported

Type of auditors' report issued on compliance for major programs: *Unqualified*

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133? Yes X No

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
10.553 & 10.555	Child Nutrition Cluster
84.027	Special Education Cluster
84.367	Title II

Dollar threshold used to distinguish between type A and type B programs: \$ 300,000

Auditee qualified as low-risk auditee? Yes X No

**HOUGHTON LAKE COMMUNITY SCHOOLS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2007**

Section II – Financial Statement Findings

Finding 2007-1 Considered a material weakness

Criteria: Material audit adjustments were proposed by the external auditor and accepted and recorded by the client.

Condition: Adjustments were not made to accurately reflect the transactions taking place at year end.

Context: During the year, there was significant turnover in the business office. During the months of July and August, prior year reversing entries were not made by the previous accountant resulting in many of the year-end adjustments.

Effect: Inaccurate financial information may be used for management decisions and reporting.

Cause: Lack of review by the staff and management of the accounting transactions that have occurred at year end.

Recommendation: The District should review year end transactions and record journal entries for any transactions not recorded.

Finding 2007-2 Considered a material weakness

Criteria: During the year, month-end reconciliations of primary asset and liability accounts were not completed in a timely manner. This resulted in year end adjustments to several accounts.

Condition: During the year, all cash and other balance sheet accounts were not adjusted and reviewed monthly.

Context: During the year, there was significant turnover in the business office. During the months of July and August, prior year reversing entries were not made by the previous accountant. This resulted in certain balance sheet accounts not being adjusted during the year.

Effect: Inaccurate interim financial information may be used for management decisions and reporting.

Cause: Completion of reconciliations primarily in the area of cash, investments, accounts receivable, accounts payable, accrued liabilities and revenue on a monthly basis was not completed.

Recommendation: The District should implement month-end procedures to appropriately reconcile primary asset and liability accounts on a timely basis. This will improve the accuracy of interim reporting.

**HOUGHTON LAKE COMMUNITY SCHOOLS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2007**

Finding 2007-3 Considered a material weakness

Criteria: Effective for the year ended June 30, 2007, Statement on Auditing Standards #112 titled *Communicating Internal Control Related Matters Identified in an Audit* (issued May 2006), requires us to communicate in writing when a client requires assistance to prepare the financial statements and footnotes required in the annual audit report in accordance with accounting principles generally accepted in the United States of America.

Condition: Currently, the District's staff prepares the interim financial reports and assists the external auditor in the preparation of the annual audit report.

Context: External assistance is required to prepare the annual audit report.

Effect: Utilization of the external auditor in preparing the financial statements and footnotes to the financial statements assists management with the external financial reporting responsibility, to ensure the financial statements are accurate.

Cause: The staff of the district does understand all information included in the annual financial statements; however, assistance of the external auditor was utilized in preparing the financial statements and footnotes to the financial statements.

Recommendation: At this time, we recommend no changes to this situation and communicate this as required by professional standards. The current process meets the definition of a material weakness as defined in Statement on Auditing Standards #112.

**HOUGHTON LAKE COMMUNITY SCHOOLS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2007**

Section III – Federal Award Findings and Questioned Costs

None

**HOUGHTON LAKE COMMUNITY SCHOOLS
SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2007**

Finding 2006-01

Criteria: During the year, month-end reconciliations of primary asset and liability accounts were not completed in a timely manner. This resulted in year end adjustments to several accounts.

Condition: During the year, the District experienced employee turnover with its Superintendent and Business Manager.

Effect: Material weakness in internal control

Cause: Completion of reconciliations primarily in the area of cash, accounts payable, accrued liabilities and revenue on a monthly basis was not completed.

Recommendation: Monthly bank reconciliations should be reviewed by an appropriate individual every month. In addition, the reconciled balance should be compared to the general ledger to ensure all necessary adjustments to the general ledger are made in a timely manner. This will improve the accuracy of interim reporting.

Status: - Significant effort was put forth in this area. Improvement was noticed, however, see 2007-2 for a repeat finding.

**HOUGHTON LAKE COMMUNITY SCHOOLS
SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2007**

Finding 2006-02

Federal Programs: Title I CFDA # 84.010, Drug Free Schools CFDA # 84.186

Specific Requirement: Cash management

Criteria: The grants in question allow for cash advances for up to 3 days of cash needs.

Condition: The District incorrectly forecasted its cash needs in March 2006, and consequently received cash advances in excess of immediate cash needs.

Questioned Costs: The District may owe interest income earned back to the Michigan Department of Education. At June 30, 2006, \$41,294 had been received and not expended.

CFDA #84.186	\$ 8,020
CFDA #84.010	<u>33,274</u>
	<u><u>\$ 41,294</u></u>

Context: During the year, the District incurred significant turnover in the business office, resulting in this error.

Effect: The District has excess cash and deferred revenue at June 30, 2006. The District received the benefit of interest earnings on the unspent federal funds.

Cause: Premature request of funds which could not be spent within the subsequent 3 days.

Recommendation: The District should base its cash advance requests on accruable expenditures which meet the 3 day cash needs criteria.

Status: This finding has been appropriately addressed.

**HOUGHTON LAKE COMMUNITY SCHOOLS
CORRECTIVE ACTION PLAN
JUNE 30, 2007
CONTACT PERSON: PETER INJASOULIAN
OVERSIGHT AGENCY: U.S. DEPARTMENT OF EDUCATION**

Houghton Lake Community Schools respectfully submits the following corrective action plan for the year ended June 30, 2007.

Auditor: Maner, Costerisan & Ellis, P.C.
544 Cherbourg Drive, Suite 200
Lansing, Michigan 48917-5010

Audit Period: Year ended June 30, 2007

The findings from the June 30, 2007 schedule of findings and questioned costs are discussed below. The findings are numbered consistently with the number assigned in the schedule.

Finding - Financial statement audit

Finding 2007-1 Considered a material weakness

Recommendation: The District should review year end transactions and record journal entries for any transactions not recorded.

Action to be taken: We concur with the recommendation. We will review year end transactions to insure that they are recorded in the proper period.

Finding 2007-2 Considered a material weakness

Recommendation: The District should implement month-end procedures to appropriately reconcile primary asset and liability accounts on a timely basis. This will improve the accuracy of interim reporting.

Action to be taken: We concur with the recommendation. We have worked diligently to resolve all issues. We are currently in the process of instituting month-end closing procedures.

Finding – 2007-3 Considered a material weakness

Recommendation: At this time, we recommend no changes to this situation and communicate this as required by professional standards. The current process meets the definition of a material weakness as defined in Statement on Auditing Standards #112.

Action to be taken: We will continue to utilize our external auditors to assist in the preparation of the annual audited financial statements and footnotes.



Lamonte T. Lator
Bruce J. Dunn
Jeffrey C. Stevens
Linda I. Schirmer
Steven W. Scott
David M. Raeck
Robert E. Miller, Jr.
Steven B. Robbins
James E. Nyquist
James R. Dedyne

Timothy H. Adams
David B. Caldwell
Edward L. Williams, III
Timothy J. Orians
Dennis D. Theis

Walter P. Maner, Jr. (1921-2004)
Floyd L. Costerisan
Leon A. Ellis (1933-1988)

October 8 , 2007

To the Board of Education
Houghton Lake Community Schools
Houghton Lake, Michigan

In planning and performing our audit of the financial statements of Houghton Lake Community Schools for the year ended June 30, 20007, in accordance with auditing standards generally accepted in the United States of America, we considered the District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, during our audit, we noted certain matters involving the internal control and other operational matters that are presented for your consideration. This letter does not affect our report dated October 8, 2007 on the financial statements of Houghton Lake Community Schools. We will review the status of these comments during our next audit engagement. Our comments and recommendations, all of which have been discussed with appropriate members of management, are intended to improve the internal control or result in other operating efficiencies.

We will be pleased to discuss these comments in further detail at your convenience, perform any additional study of these matters, or assist you in implementing the recommendations. Our comments are summarized as follows:

Prior Year Comments - Overview

The District considered and attempted to implement all prior year recommendations. During the year the District implemented new procedures and improved controls during the year. The District was also extremely successful in improving the financial status of the District. While many new procedures were implemented, certain significant prior year recommendations were not completed. Several of these issues relate to the turnover in the accounting department primarily from August - September.

Prior Comments addressed:

Financial Condition and Possible Future Effect on Audit Opinion

It was noted during our audit that Houghton Lake Community School's has had a negative change in general fund, fund balance for the past three years and now has a fund balance of approximately \$199,000 as of June 30, 2006. This indicates that Houghton Lake Community School's is approaching becoming theoretically insolvent in that its liabilities exceed its assets. We strongly recommend that management and the Board of Education evaluate the reasons why this condition has occurred. Future plans and budgets should then be developed to produce a plan to avoid continuing deficits. Please be aware that continuation of these negative financial results can impact the type of audit opinion that can be issued in the future. This situation is critical and may very well impact the future ability of Houghton Lake Community School's to conduct its affairs in the manner it is accustomed to.

Status: The District has implemented operational procedures to significantly improve the financial condition of the District. The current year audit report from the year ended June 30, 2007 indicates a significant increase in the general fund, fund balance.

Computer Passwords

We understand that computer passwords are not changed on a regular basis. In order to reduce the risk of access to computer files by unauthorized personnel, we recommend the District institute a policy that requires passwords to be changed on a regular basis. The District may also wish to investigate building into its software automatic expiration of passwords to ensure that they are changed periodically.

In addition, the District should consider a standard setting whereby computers are logged off of the network after a predetermined amount of inactivity.

Status: The District has implemented this recommendation passwords are now changed quarterly.

Dating of Checks

During our audit procedures, it was noted that checks issued in July and August 2006 were dated using a June 2006 date. These checks were then included in the list of June 30, 2006, outstanding checks as if they had been issued in June. Proper cutoff is extremely critical in all aspects of accounting. Any process or procedure that holds the books open or closes them in advance will yield inaccurate financial results. We strongly recommend that all check disbursements be dated using the date the check is actually produced.

Status: The District has implemented this recommendation.

Retirement Incentive Accounting

Currently the District has commitments to former employers who have retired. The legally enforceable due date for payments is July 1st of each year. The Michigan Department of Education Accounting Manual interprets (GASB) Interpretation #6 *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* as requiring a liability and corresponding expenditure to be recorded in the general fund on the legally enforceable due date.

In prior years payments due on July 1st were paid prior to June 30th and recorded as an expenditure in the year paid. For the year ended June 30, 2006, the July 1, 2006 payment was made after year-end. This results in \$140,000 of payments to be recorded as expenditures in the 2006 - 2007 fiscal year. Should the July 1, 2007 payment be made prior to July 1, 2007, then this amount will also be recorded as an expenditure in 2006 - 2007.

For the year ended June 30, 2006 early retirement incentive expenditures for teachers were zero because the payment was not made by June 30, 2006. This results in allowable inconsistency. We bring this to your attention to consider when amending your 2006 - 2007 budget.

Status: This retirement incentive has been properly recorded in the current period audit report. \$45,000 will be recorded as an expenditure during the fiscal 2007-2008 year when paid.

Physical Inventory of Fixed Assets Needs to Be Taken Periodically

During the last fiscal year, physical inventories of fixed assets were taken for the first time in many years and significant amounts of fixed assets were written off because numerous assets had been disposed of or otherwise taken out of operation in prior years. These transactions have been adjusted on the accounting records. We suggest that physical inventories of fixed assets be taken periodically and related records be timely and appropriately updated, to prevent differences in the future. Also, a complete and accurate inventory of fixed assets will provide for much stronger control to detect any future fixed asset removal or disposition without proper authorization.

Status: A property inventory was conducted by Industrial Appraisal Company and an accounting was provided at that time.

Fixed Asset Disposals Policy Needs to Be Implemented

At present, Houghton Lake Community School's does not have a formal procedure to ensure that disposals of fixed assets, whether by destruction, sale, scrapping, or trade-in, are reported to the accounting department. Without such a procedure, the likelihood of a disposal going unrecorded increases substantially. A formal policy to ensure the reporting of fixed asset dispositions should be adopted and should require the necessary level of approvals based on the value of the asset. We suggest that a simple yet standardized form be developed to provide adequate approvals for disposal, details, and other pertinent information as evidence of adherence to the District's policy. This form would also provide the necessary accounting documentation for recording the disposal into the books of account.

Status: Annually disposals are reviewed as part of the annual audit.

Establish System of Management Approval of Purchases

We noted that there is no system of effective review for purchases. This is a serious weakness of the system of internal controls and this opens the way for the possibility of not only unapproved but also fraudulent purchases. We suggest that purchases in excess of a certain dollar limit, established by management, be approved and that this approval be documented by a signature and date on the purchase order and invoice.

Status: The purchase order system has been reviewed and new procedures have been implemented during the year.

Control over District Credit Cards

During our audit procedures, it was determined that as many as twenty employees, possess and use District credit cards. Furthermore, the cards are used for a variety of purchases, including for charges other than travel expenses. We recommend that District credit cards be limited or eliminated in order to strengthen the internal controls over disbursements and help prevent misappropriation of assets.

Status: The District no longer uses credit cards.

Payroll Review

Our audit testing of payroll procedures disclosed that only one employee in the accounting department performs the complete payroll process. This is contrary to the establishment of strong internal controls regarding segregation of duties and makes Houghton Lake Community School's vulnerable in this area. While we clearly understand the limitations on obtaining an adequate segregation of duties with such a small staff, we feel that the Business manager (when hired) should review the payroll on a regular basis. This review should include which employees are listed on payroll, amounts at which they are paid, reasonableness of withholdings, correct account distribution and the assurance that all related payroll taxes are being paid.

Status: The District has implemented this comment.

Distribution of Paychecks

Presently paychecks for staff located throughout the District are distributed by the maintenance supervisor who is also the payroll clerk's husband. In order to improve controls over payroll, we recommend that someone other than payroll clerk's husband, distribute the paychecks to the staff.

Status: The District has implemented this comment.

Federal Grants Reporting: Timely and Accurate Reporting

Our audit procedures revealed that there were instances where reports required to be filed under the grant agreement were either not filed at all or filed after the due date. We strongly recommend that Houghton Lake Community School's institute policies and procedures that stipulate that the required reports must be filed by their respective due dates. It is critically important that timely and accurate reports be produced to ensure that the goals and purposes of the grant have been achieved and accounted for properly. We commend Houghton Lake Community School's on maintaining separate cost centers for each federal funding source to more clearly reflect activity on a grant-by-grant basis. Houghton Lake Community School's should use these expenditure reports to assist in filing the federal grant requests.

Status: The reports reviewed were filed timely.

Employment Contracts

During the audit, we read certain employment contracts the District has entered into with various union groups. We noted these contracts do not include the dates when an employee will receive fringe benefits. Currently for teachers the first month of insurance in a fiscal year is the month of September. This requires a two month accrual at year-end to include the subsequent months of July and August as expenditures in the previous year. The Districts' practice for all other employees is the first month of insurance in a fiscal year is July. We recommend the District clarify in the contracts the first date an employee will receive compensation and fringe benefits.

Status: The District has informed us new contracts have been implemented and language has been clarified.

Budget Enforcement by the Michigan Department of Education

The Michigan Department of Education is changing their enforcement and monitoring of budget violations. They are currently focusing on total expenditures violations that exceed 1% of the total expenditures budget and total other financing uses that exceed 1% of the total other financing uses budget. The Department of Education will be issuing letters to school board presidents, the superintendent and the chief business official when they identify these types of violations.

Currently identified violations of the Act include, but are not limited to:

- Incurring expenditures in excess of the appropriation approved by the school board.
- Ending the fiscal year with a negative general fund balance.
- Adopting a budget that, when implemented, would put the District in a deficit.

The Department is also currently reviewing their interpretation of Section 17(2). This would be a situation where a District's actual revenues were less than budgeted revenues and, at the same time, depleted the District fund balance, beyond what was approved in total by the school board.

We recommend you continue to review your current budget amendments during the year. There will be situations where there continues to be budget violations as disclosed in footnote 2 subsection 3 of the financial statements. While there may be technical violations of the act we believe the District's current budget procedures should be monitored during the year to avoid budget violation letters from the Michigan Department of Education.

The District should review its budget in the areas of state revenue, instruction, support services pupil and support services pupil transportation. These were areas which had negative variances this year.

Status: The District's budget procedures ensured an overall favorable variance at the end of the year.

Cash Management - Federal Awards

The Michigan Department of Education has recently been notified that it, along with all other states, has misinterpreted the advance provision of the Cash Management Improvement Act (CMIA). The United States Department of Education started monitoring and auditing CMIA compliance and is notifying sub-recipients that advances are limited to three days cash needs. In other words, funds must be spent by the District within 72 hours of being drawn down from the USDE GAPS system. Because of this new awareness, the department will no longer allow 30-day cash advances for ongoing programs during fiscal year 2006/2007. Thirty-day cash advances may be permitted for new one-time federal grant programs at the discretion of program management.

We recommend the District request funds on a reimbursement basis in order to ensure compliance with the revised cash management interpretation. In March 2006, the District requested the remaining balance of certain federal awards. Federal award money was not spent by June 30, 2006; this was a direct violation of the Cash Management Improvement Act.

Status: The District did not have any cash management findings.

New Auditing Standards

Recently, 10 new auditing standards have been released and will become effective over the District's next two fiscal years. In reviewing the new standards, we do not believe, for the most part, they will have a significant impact on our overall audit approach. However, two of the new standards may directly impact the District beginning with the June 30, 2007 year-end.

One of the new standards revises the dating of the auditors' report. Under the old standards, the auditors' report was dated the last day of fieldwork. The new standards define the date as the date adequate audit evidence is obtained. Adequate audit evidence is now being interpreted as including the client's approval of draft financial statements. Although the dating of the report may seem trivial to non-auditors, it does have an impact on auditors' subsequent events work (June 30 through date of the auditors' report). The impact to the District could be if there was a long period of time needed to resolve certain open issues. This would extend the dating of the auditors' report and increase the amount of work we need to complete our subsequent events work.

Another standard effective for the June 30, 2007 year-end is related to our communications with the client. The new standard retained the definition of a "material weakness" and added two new categories of deficiencies "significant deficiency" and "control deficiency". Certain situations were included as examples of strong indicators of significant deficiencies and possibly material weaknesses. One of the situations is the client is unable to write financial statements, including the footnotes, in accordance with generally accepted accounting principles. Historically, we have prepared the financial statements and footnotes for the District. We will have to evaluate the District's ability to produce appropriate financial statements and footnotes and, accordingly, if any control deficiencies exists.

Status: The District requires our assistance to prepare the annual audit report.

Repeat Prior Year Comments:

Student Activity Funds

In prior years it was recommended the financial records of the internal funds at each location provide a monthly activity report to the corresponding teacher or organizational leader.

Status: These reports are now distributed monthly. Certain adjustments need to be made on a monthly basis to reconcile cash balances to the general ledger.

Cash Receipts: Segregation of Duties

We noted there was a lack of segregation of duties within the cash receipts area. The objective of internal control over cash receipts is to obtain control over amounts received at the time of receipt. We feel that separating these closely related functions in the cash receipts system of Houghton Lake Community School's will result in much greater internal control in this particular area. To achieve this control, certain duties involving receipts should be handled by more than one member of Houghton Lake Community School's personnel. The following procedures should be enacted to ensure efficient internal control:

- One employee, preferably the receptionist, should open the mail, make a control list of all receipts, and restrictively endorse all items received as "for deposit only." This would prevent any unauthorized endorsement should the checks be misplaced or lost before being deposited.
- The receipts should then go to another employee for further processing and deposit to the bank on a timely basis.
- Finally, someone who does not otherwise handle receipts should compare the deposit slips to the list of receipts to ensure that all funds reflected on the control list were deposited in a timely manner.

Status: The District has implemented certain procedures. The initial listing of cash receipts should be compared to the bank deposit amount by a person other than the individual creating the initial listing. This comparison should be documented by initialing the bank deposit on the initial listing to indicate the two accounts have been reviewed and reconciled.

School District Needs a Business Manager

The business manager position, a key position, is currently vacant. Since that time, Houghton Lake Community School's has experienced many problems in the accounting and finance area. The vacancy left by the Business Manager requires that other employees in the accounting department perform the business manager's duties while still completing their own work. After an extended period of time, working under these conditions, the likelihood for errors increases and the likelihood of employee turnover will also increase. In addition, segregation of duties is diminished. We recommend an experienced individual be selected to fill this position as soon as possible.

Status: With the improved financial condition of the District we again recommend an experienced individual be selected to fill this position as soon as possible.

Disaster Recovery Plan

The District utilizes a third party service provider to host its primary student and financial applications. Despite this the District has a number of applications and corresponding data that is maintained by the District. While the District performs daily backups of these systems we recommend a formal disaster recovery plan be developed and documented for its in-house applications. We understand the third party service provider has updated and documented its disaster recovery procedures during the current year.

Status: We repeat this comment, the District has not had time to address this issue.

Current Year Comments

New Notification Requirements for Related Not-for-Profit Organizations with Gross Receipts of \$25,000 or less Such as Booster Groups and PTO's

The Pension Protection Act of 2006 requires these organizations to file an annual electronic notice for tax periods beginning after December 31, 2006, if these organizations are not required to file Form 990 (or 990-EZ), Return of Organization Exempt From Income Tax because their gross receipts are normally \$25,000 or less.

If they are a section 509(a)(3) supporting organization, generally, they must file a paper or electronic Form 990 (or Form 990-EZ) even if their gross receipts are normally \$25,000 or less. However, if they are a supporting organization of a religious organization and their gross receipts are normally \$5,000 or less they may file an annual electronic notice instead of Form 990 (or Form 990-EZ).

The annual electronic notice is due by the 15th day of the fifth month after the close of their tax period. For example, if their tax period ends on December 31, 2007, the annual electronic notice is due May 15, 2008.

The notice will require these organizations to provide the following information:

- Organization's legal name,
- Any other names your organization uses,
- Organization's mailing address,
- Organization's website address (if applicable),
- Organization's employer identification number (EIN),
- Name and address of a principal officer of your organization.
- Organization's annual tax period,
- Verify that your organization's annual gross receipts are still normally \$25,000 or less, and;
- Indicate if your organization has terminated (is no longer in business).

IRS 403(b) Final Regulations

Intent

The intent of the regulations is to consolidate guidance on §403(b) plans issued since 1964.

Effective Date

These regulations are generally effective for taxable years beginning after December 31, 2008. Plan documents should be in place December 31, 2008 to be implemented as of January 1, 2009.

Written Plan Document

The IRS is working on a model plan document and guidance for school districts. This should contain the provisions necessary for compliance with the new rules.

New Interpretation Of Deferred Compensation Rules Applicable To Teachers And Similar Employees

In August of 2007, the IRS issued new questions and answers related to deferred compensation which can effect teachers and similar employees.

When employees can elect to defer part of their compensation to a future year, they are generally subject to the rules applicable to deferred compensation under the Internal Revenue Code. These payments could be subject to an additional 20% tax if the specified procedures are not followed. For example, school employees who work 10 months but are paid over 12 months would be deferring compensation into a future year. If a school district provides that all employees must spread their pay over 12 months, these rules do not apply.

In order to avoid imposition of extra taxes, the employees must give a written or electronic election to notify the employer that they want to spread out the compensation. This election must be provided before the start of the school year and must be irrevocable. The election must state how the compensation is going to be paid (for example, ratably over the 12 months starting with the beginning of the school year). This election does not need to be made for future years if the arrangement provides that the election will remain in place until the employee elects a change. These rules are effective January 1, 2008. Therefore, they are not applicable until the election for the 2008 - 2009 school year.

New Auditing Standards

Recently, 10 new auditing standards have been released and are effective, or will become effective for your June 30, 2008 year end. In reviewing the new standards, they will have an impact on our overall audit approach. The trend is to perform audit procedures utilizing more of a risk based approach. One area which will continue to be emphasized is your internal controls.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with various District personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

To the Board of Education
Houghton Lake Community Schools
Houghton Lake, Michigan

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October 8, 2007

This report is intended solely for the information and use of Houghton Lake Community Schools, management, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

We appreciate the cooperation we received from your staff during our engagement and the opportunity to be of service.

Very truly yours,

Mamie Costenson & Ellis, P.C.



Lamonte T. Lator
Bruce J. Dunn
Jeffrey C. Stevens
Linda I. Schirmer
Steven W. Scott
David M. Raeck
Robert E. Miller, Jr.
Steven B. Robbins
James E. Nyquist
James R. Dedyne

Timothy H. Adams
David B. Caldwell
Edward L. Williams, III
Timothy J. Orians
Dennis D. Theis

Walter P. Maner, Jr. (1921-2004)
Floyd L. Costerisan
Leon A. Ellis (1933-1988)

October 8, 2007

To the Board of Education
Houghton Lake Community Schools
Houghton Lake, Michigan

We have audited the financial statements of Houghton Lake Community Schools for the year ended June 30, 2007, and have issued our report thereon dated October 8, 2007. Professional standards require that we provide you with the following information related to our audit.

1. Our Responsibility under Auditing Standards Generally Accepted in the United States of America and OMB Circular A-133

As stated in our engagement letter, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered Houghton Lake Community School's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether Houghton Lake Community School's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of law, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about Houghton Lake Community Schools' compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each of its major programs for the purpose of expressing an opinion on Houghton Lake Community Schools' compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on Houghton Lake Community Schools' compliance with those requirements.

2. Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by Houghton Lake Community Schools are described in Note 1 to the financial statements. We noted no transactions entered into by Houghton Lake Community Schools during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

3. Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Management's estimate of the liability of the payout for the employee compensated absences upon their retirement is based on expected payout; the balance reported for compensated absences was approximately \$500,000 and accumulated severance benefits were approximately \$240,000. We evaluated the key factors and assumptions used to develop the balance of compensated absences in determining that it is reasonable in relation to the financial statements as a whole.

Certain amounts included in capital assets have estimated based on an outside appraisal company. Certain allocations on the statement of activities allocating revenue between instruction and support services have been used in preparing the statements.

4. Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Houghton Lake Community Schools' financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, certain adjustments we proposed, recorded by the Houghton Lake Community Schools, either individually or in the aggregate, indicate matters that could have a significant effect on the Houghton Lake Community Schools' financial reporting process. This has been separately reported to the district.

5. Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

6. Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

7. Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Houghton Lake Community Schools' auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

8. Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit. We did incur additional time auditing certain balance sheet accounts.

This information is intended solely for the use of the Board of Education, management, and federal awarding agencies and pass-through entities of Houghton Lake Community Schools and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Mamie Costeniser & Ellis, P.C.